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Regions Financial Corp. (RF)

Q1 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Regions Financial Corporation's quarterly earnings call. My name is Shelby, and I'll be your operator for today's call. I would like to remind everyone that all participants' phone lines have been placed on listen-only. At the end of the call, there will be a question-and-answer session. [Operator Instructions]

I will now turn the call over to Dana Nolan to begin.

Dana W. Nolan

Executive Vice President-Head of Investor Relations, Regions Financial Corp.

Thank you, Shelby. Welcome to Regions' first quarter 2019 earnings conference call. John Turner will provide highlights of our financial performance, and David Turner will take you through an overview of the quarter. A copy of the slide presentation as well as our earnings release and earnings supplement are available under the Investor Relations section of regions.com.

Our forward-looking statements disclosure and non-GAAP reconciliations are included in the appendix of today's presentation and within our SEC filings. These cover our presentation materials, prepared comments, as well as the question-and-answer segment of today's call.

With that, I will now turn the call over to John.

John M. Turner, Jr.

President, Chief Executive Officer & Director, Regions Financial Corp.

Thank you, Dana, and thank you all for joining our call today.

Let me begin by saying we're pleased with our first quarter results. The momentum we experienced in the fourth quarter has continued into 2019. We reported earnings from continuing operations of $378 million, delivering solid year-over-year revenue growth, broad-based loan growth and stable but normalizing asset quality, all while reducing expenses and generating positive operating leverage.

Loans grew somewhat faster than we anticipated in the quarter, driven in part by increased line utilization by our business customers. We intentionally funded a portion of this incremental loan growth with commercial and corporate treasury deposits. And while this was more economical than wholesale borrowings, deposit costs were impacted during the quarter. We expect loan growth will moderate through the remainder of the year, providing opportunities to optimize our deposit mix.

With respect to the economy, we feel good about the health of the consumer and businesses. I've traveled across our footprint in the last few weeks to markets including Tampa, West Palm Beach, Atlanta, Nashville, Houston, Greenville and Spartanburg, South Carolina, and Mobile, Alabama. I've met with clients of varying sizes and industries, and customer sentiment remains positive.

Many customers experienced record revenues in 2018 and are expecting even better results in 2019. In general, our clients do not expect a recession in the near term, and neither do we. That being said, we remain focused on building a balance sheet that will position us for consistent and sustainable performance through all phases of the economic cycle.

The outlook for the interest rate environment continues to evolve. Clearly, lower rates and the shape of the yield curve makes near-term revenue growth more challenging for the industry. However, as we did over the last four or five years, we will make the necessary changes and adapt to the evolving market conditions.

In the meantime, we'll continue to focus on the things we can control: providing customers with the quality financial products and services they need; maintaining appropriate risk-adjusted returns; prudently managing our interest rate sensitivity profile; and effectively controlling expenses while continuing to make investments in technology and talent. Again, we are pleased with our financial results this quarter. Our focus on continuous improvement remains key to our ability to generate consistent and sustainable long-term performance.

With that, I'll now turn the call over to David.

David J. Turner, Jr.

Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

Thank you, John.

Let's begin on slide 3 with average loans and deposits. Adjusted average loans increased 2% over the prior quarter, driven by broad-based growth in the business lending portfolio and relatively stable balances across the consumer lending portfolio. Once again, all three areas within our Corporate Banking Group experienced broad-based loan growth across industries and geographic markets.

Adjusted average business loan growth was led by a 4% increase in adjusted commercial and industrial loans, where growth was driven by our diversified specialized lending and REIT lending portfolios. Average investor real estate loans grew 8% in the first quarter, while average owner-occupied commercial real estate loans declined 4%. Both were impacted by a reclassification of approximately $345 million of senior assisted living balances from owner-occupied commercial real estate to investor real estate at the end of last year. Excluding the impact of this reclassification, average investor real estate loans increased approximately 3%, driven by growth in term real estate lending, which is consistent with our strategic initiative to achieve better balance between term and construction lending. As John noted, a 160 basis point increase in line utilization also significantly contributed to this quarter's loan growth.

With respect to consumer, adjusted average loans remained relatively stable, as growth in the indirect-other consumer and credit card portfolios was offset by a decline in home equity lending. Average mortgage loans remained relatively stable. However, the sale of $167 million of affordable housing residential mortgage loans late in the first quarter will impact second quarter average balances. Despite solid growth this quarter, we continue to expect full-year 2019 adjusted average loan growth in the low single digits.

So with respect to deposits, we continue to execute a deliberate strategy focusing on growing low-cost consumer and relationship-based wealth and business services deposits. Total average deposits increased 1% during the quarter, reflecting 1% growth in consumer and 2% growth in corporate, partially offset by declines in wealth and other. Importantly, our bankers continue to grow new consumer checking accounts and consumer households as well as corporate deposit accounts and total wealth relationships.

Let's take a closer look at the composition of our deposit base. To protect our deposit advantage, we continue to execute strategies to ensure we are effectively serving our customers. These strategies facilitated growth in interest-bearing checking, money market, and time deposits at the end of last year, which contributed to total average deposit growth this quarter.

Increasing deposit rates combined with overall deposit growth and portfolio remixing drove an increase in total deposit costs this quarter to 46 basis points. Despite the increase, we remain well positioned relative to peers, further illustrating the significant funding advantage provided by our deposit base. Our cumulative interest-bearing deposit beta increased to 25% this quarter. Assuming no additional rate increases from the Federal Reserve, we expect a through-the-cycle deposit beta in the low 30% range.

Retail deposits include consumer and private wealth deposits. Our cumulative retail interest-bearing deposit beta increased to 10% this quarter, while our cumulative consumer deposit beta remained low at just 6%. As previously noted, a portion of this quarter's loan growth was funded with commercial deposits contributing to additional pressure on overall deposit costs. However, we remain committed to our long-term return targets and we will continue to optimize both sides of the balance sheet.

So, let's look at how this impacted our results. Net interest income decreased 1% over the prior quarter and net interest margin decreased 2 basis points to 3.53%. Both net interest income and margin benefited from higher market interest rates, offset by higher funding cost, including the impact from our January parent company debt issuance. Net interest income also benefited from higher average loan balances, but was negatively impacted by two fewer days in the quarter. Net interest margin, however, benefited from fewer days, but was negatively impacted by average commercial loan growth.

In the current interest rate environment, growth in net interest income and margin will be driven by balance sheet growth and business mix. With respect to net interest margin, rates consistent with the current yield curve and moderate balance sheet growth is expected to generate a relatively stable to modestly lower full-year margin, implying moderate margin compression for the rest of 2019. With that said, we continue to expect full-year adjusted revenue growth of 2% to 4%.

With respect to fee revenue, adjusted non-interest income increased 4% this quarter, compared to the fourth quarter of last year. Significant asset valuation declines in the fourth quarter associated with market volatility improved in the first quarter. Favorable market value adjustments on total employee benefit assets increased $19 million, while also contributing to an $11 million increase in bank-owned life insurance income. The increase in bank-owned life insurance also included additional claims income compared to the prior quarter. As we look forward, we are taking actions to reduce future volatility associated with certain of these assets.

Service charges and card and ATM fees declined 5% and 2%, respectively, reflecting seasonality and fewer days in the quarter. Capital markets income decreased 16%, attributable to lower loan syndication income and fees generated from the placement of permanent financing for real estate customers, partially offset by an increase in merger and acquisition advisory services and higher revenues associated with debt underwriting. As you know, capital markets income can be volatile from quarter-to-quarter. However, we do expect an increase in the second quarter.

Mortgage production and sales revenue increased compared to the prior quarter. However, total mortgage income decreased 10%, primarily due to lower hedging and valuation adjustments on residential mortgage servicing rights. Other non-interest income includes an $8 million gain associated with the sale of $167 million of affordable housing residential mortgage loans late in the first quarter. In addition, fourth quarter other non-interest income included a net $3 million decline in the value of certain equity investments and a $5 million loss associated with impairment or disposal of lease assets.

Let's move on to expenses, which we believe were well controlled in the quarter. On an adjusted basis, non-interest expense increased 1% compared to the fourth quarter, primarily due to a 2% increase in salaries and benefits, reflecting higher payroll taxes, as well as an increase in expense associated with Visa class B shares sold in a prior year. Partially offsetting these increases, occupancy expense decreased 5% primarily due to fourth quarter storm-related charges associated with Hurricane Michael.

Furniture and equipment expense decreased 7% primarily due to a benefit in property taxes recorded during the quarter, and professional fees decreased 26%, driven primarily by a reduction in consulting fees. The adjusted efficiency ratio was 58.3% and the effective tax rate was approximately 21%. For the full year, we continue to expect relatively stable adjusted expenses and an effective tax rate between 20% and 22%.

So let's shift to asset quality. In line with our expectations, asset quality remained stable, while continuing to normalize this quarter. Net charge-offs improved 8 basis points to 0.38% of average loans. Including the impact of loan growth, the provision for loan losses exceeded net charge-offs, resulting in an allowance equal to 1.01% of total loans and 163% of total non-accrual loans. Total delinquent loans decreased $102 million as loans 30 to 89 days past due decreased $106 million, while loans 90 days or more past due increased modestly.

Total non-performing loans, excluding loans held for sale, increased 2 basis points to 0.62% of loans outstanding. Business services criticized and troubled debt restructured loans increased $197 million and $27 million, respectively. These results include the recently concluded Shared National Credit exam. While overall asset quality remains within our stated risk appetite, volatility in certain credit metrics can be expected. We continue to expect full-year net charge-offs in the 40 basis point to 50 basis point range.

Let me give you some brief comments related to capital and liquidity. During the quarter, the company repurchased 12.2 million shares of common stock for a total of $190 million through open market purchases and declared $142 million in dividends to common shareholders.

We continue to execute our 2018 capital plan. And as you know, we're not required to participate in the 2019 CCAR process. However, we were required to provide our updated planned capital actions to the Federal Reserve in early April. These planned capital actions, which remain subject to approval by our board of directors, provide a path for us to achieve our targeted 9.5% Common Equity Tier 1 ratio this year. At quarter end, loan-to-deposit ratio remained unchanged at 88% and the company continued to be fully compliant with liquidity coverage ratio rule. Our full-year 2019 expectations provided at Investor Day remain unchanged and are summarized on this slide for your reference.

So, in summary, we are pleased with our first quarter financial results. Despite market uncertainties, we are focused on things we can control. We have a solid strategic plan and are committed to achieving our 2019 and long-term targets.

With that, we're happy to take your questions, but do ask that you limit them to one primary and one follow-up question. We will now open the line for your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. The floor is now open for questions. [Operator Instructions] Your first question comes from Ken Usdin of Jefferies.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Good morning, Ken.

Ken Usdin
Analyst, Jefferies LLC

Q

Hey, good morning, guys. Thanks. David, just on your comments about the outlook for the changing rate environment and the potential pressures that brings forth, can you talk through where that manifests itself the most, is it the investment portfolio, is it loan spreads and if you could go a little bit further into that ability to kind of remix those deposits as you move through the year? Thanks.

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

Sure, Ken. So, yeah, we've looked at the rate environment clearly changed since going into the year, not anything different than we've experienced before. As we showed you at Investor Day, we had a three-year outlook, if rates were lower than we thought and we adapted and overcame that, and we'll do it again this time.

As we think about rates from a reinvestment standpoint, we still have a front book, back book benefit. It's not as much as it was originally, but we still benefit from that. This particular quarter, we had a couple of things that impacted us. We had loan growth that was a little stronger than we had anticipated with 160 basis point increase in line utilization. We had to fund that and we chose to fund that with higher cost deposits versus going to the wholesale market.

So if you look at deposit betas, that caused our deposit beta to be up. Our overall funding beta is kind of in line with peers. But we thought that was the right thing to do. The loans that we've put on were a little thinner spread, which put a little pressure on our margin. The margin actually was impacted by our parent company debt issuance we had in the first quarter as well as a reclassification of purchasing card assets that don't carry any interest carry. Those two things were 2 basis points of margin in the quarter.

So as we look forward, what we need to do is continue to remix the balance sheet, both on the loan side and the deposit side, as we seek to optimize both levels to get our net interest income where we want it to be and the resulting margin.

I will go ahead and answer the question because it's probably coming up that our margin expectation for the year we believe to be commensurate with what we had last year, in the 3.50% range, give or take a point or two. So that's how we see the rates and our expectation for the year.

Ken Usdin
Analyst, Jefferies LLC

Q

Got it, okay. And then one follow-up on the loans, you've reiterated that with a good start to the loan growth, the adjusted loan growth, can you give us an idea of just the summary of the non-core – the combination of the auto stuff and then the new loans you sold and what you expect that would be on the full year? Thanks, David.

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp. A

So we're still guiding on the adjusted loans that carves out the run-off portfolios to be in the low single digits. You'll see some of the remixing there. A little bit of that growth that you saw in the first quarter, where companies that have access to the capital markets that chose to come to the bank market because it's cheaper, we expect that to change over time. And so you should expect some run-off there, and we'll refill that still to get our low single-digit growth. The auto book continues to run down. We'll be in the $700 million – $800 million range on those run-off portfolios.

Ken Usdin
Analyst, Jefferies LLC Q

Got it. Thanks, David.

Operator: Your next question comes from John Pancari of Evercore.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp. A

Good morning, John.

John Pancari
Analyst, Evercore Group LLC Q

Good morning. Just on that point, on the deposit and margin commentary there, given the loan growth you saw in the quarter, you said it came in a little bit better. Why did you make the decision to fund that growth with higher-cost funding versus deposits?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp. A

No, what I said was we chose to fund that with higher-cost deposits versus wholesale funding, because the deposit growth was cheaper than what funding was. And what I was trying to address is the deposit beta was negatively impacted because of that decision. If you look at our total funding beta, our total funding beta was fairly consistent with the peers. So it's just a mix of what we chose to fund that growth with versus what somebody else might have done.

John Pancari
Analyst, Evercore Group LLC Q

Okay, thank you. And I misunderstood it. I just wanted to get clarity on that. Okay, and then separately, around the loan growth expectation for the year and that you expect it to slow from here, could you just talk about some of the give and takes about what you think will drive to the net moderation off of this level versus any incremental strengthening on the commercial side, for example?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp. A

So as John mentioned in his comments, we feel good about – our customers feel good about the economy, and they're continuing to borrow. That increase we saw, part of that this first quarter again were customers we believe have access, we know have access to the capital markets that chose to use their bank lines of credit to give them more flexibility in terms of timing on when they would go to the capital market system. It's just a matter of time before that happens. So we're going to see those loans run out of the bank as we continue to grow consistent with our expectations at the beginning of the year. So when you get net-net to the end of the year, we think net loan growth is still in the low single digits.

John Pancari
Analyst, Evercore Group LLC

Q

Okay. Thanks, David. And one last thing on credit, can you just give us a bit of color around the drivers of the higher classified and special mention loans, and I guess your thought around the longer-term loan loss reserve level here? I know it stands around 1.01%. I wanted to get your thoughts on where that could trend to.

Barbara I. Godin
Executive Vice President, Consumer Banking Credit Executive, Regions Financial Corp.

A

Certainly, John. It's Barb Godin. Relative to criticized and classified, in terms of those numbers, that's attributable to really two or three credits that moved over. And given the lows that we're on, it's simply starting to slowly normalize. Also recall that our results include the results of the recently completed Shared National Credit survey, or credit exam, so that's all-encompassing. We don't see any trends in there that we're looking at that concern us at all at this point. And in terms of our loan loss reserve, we're sitting at 1.01%. We think that area, 1% – 1.01%, is probably the right number as we look forward as well until we get to CECL next year.

John Pancari
Analyst, Evercore Group LLC

Q

Got it. Thank you, Barb.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

John, I would just reiterate that. I think we still feel very good about our credit metrics. As Barb said, we're really at better than 10-year lows in terms of criticized, classified, and non-performing loans. And so from time to time, we're going to see a little movement up or down, I think, in those metrics. In this particular quarter, as Barb mentioned, we had one or two credits that impacted both criticized loans and non-performing loans. And so given the low base we're coming off, I think you're going to see some back-and-forth there over the coming quarters as credit begins to normalize a bit, but we feel still very good about our credit quality.

John Pancari
Analyst, Evercore Group LLC

Q

Okay, got it. Thanks.

Operator: Your next question comes from Betsy Graseck of Morgan Stanley.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Good morning, Betsy.

Betsy L. Graseck
Analyst, Morgan Stanley & Co. LLC

Q

Hi. Good morning. Hi.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Good morning.

Betsy L. Graseck
Analyst, Morgan Stanley & Co. LLC

Q

I just had a question on your capital target. I know you mentioned that with the expectation that you have for buyback this coming year, you should be able to get to 9.5% target CET1. I'm just wondering if given the proposal that that has for its NPR that's outstanding out there for banks your size, would you be at all rethinking the target CET1 at any point or is that something that you think you need to have as high as 9.5% going forward?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

Betsy, we had mentioned at Investor Day that mathematically our capital that we think we need based on the risk profile that we have would lead one to a Common Equity Tier 1 of 9% and we said to those attending and listened that we added another 50 basis points of cushion on that. We believe that that capital level, one, provides the proper capital we need to have, plus a little bit, while allowing us to get to our return expectations that we also laid out. So, those targets were not derived based on supervisory input or the CCAR mechanism. So I don't see that changing at all.

As you know, we have to get through the second quarter which is based on last year's submission and in the third quarter, we'll start – we're not under CECL, but it'll start our capital plan. And that's why we have confidence we will get to our 9.5% by the end and we'll have – we'll be able to toggle between loan growth and share buybacks as we seek to manage the capital at that level.

Betsy L. Graseck
Analyst, Morgan Stanley & Co. LLC

Q

Okay. It just seems very – there's a lot of cushion in there, so I'm wondering maybe it reflects the view that you feel your portfolio might be a little more risky than peers or you're just super conservative?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

Well, as I mentioned, our math, based on our risk profile, would lead you to 9%. We choose to have an extra 50 basis points in there which we think gives us flexibility especially as you think about where we are in a 10-year run. And if the economy were to turn down, we have the ability to perhaps take advantage of some opportunities that might come our way to invest in the assets that could give us growth. So it's – we think an appropriate amount of cushion because it did weigh us down from our return objectives and gives us that flexibility. So that's why we do it.

Betsy L. Graseck
Analyst, Morgan Stanley & Co. LLC

Q

Yeah. I got it. Thank you.

Operator: Your next question comes from Erika Najarian of Bank of America.

Erika Najarian
Analyst, Bank of America Merrill Lynch

Q

Hi, good morning.

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

Good morning, Erika.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Good morning, Erika.

Erika Najarian
Analyst, Bank of America Merrill Lynch

Q

Good morning. I wanted to follow-up on the comments on capital actions. So, if we filled in the template that the Fed distributed, we're getting to about a max pre-approved capital action of about $2.15 billion for 3Q 2019 to 2Q 2020. And I'm wondering if that's ballpark with how your team calculated the template?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

Well, I think, again, the way we want you to get there is by looking at our target of Common Equity Tier 1 of 9.5%. We think that the toggle we have to think through on buyback is what's loan growth going to look like? We've said we want to payout a dividend in the 35% to 45% range, so that uses a piece of it, of earnings. And then the rest of it is either going to be used for loan growth or it's going for the most part or we're going to buy shares back. So trying to now stipulate exactly what that buyback is going to be is, one, we don't think it's necessary as much because we're giving you what the end result is going to be. So you have to come up with your expectation of what our loan growth is going to be, help you get your buyback number.

Erika Najarian
Analyst, Bank of America Merrill Lynch

Q

Oh, I meant all-in. Okay. And just taking a step back, you unveiled a mid-term efficiency ratio of 55% or below during your Investor Day. And, of course, the curve dynamics have gotten less friendly since. I'm wondering as we think through the next few years, is there that much expense leverage left to be able to get you to this target of less than 55% by 2021 with this type of curve backdrop, or are we underestimating some of the investments that you're making that could boost revenue beyond rates beyond 2019?

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Yeah, Erika, I would say it's a combination of both. First of all, we're committed to 55% efficiency ratio by the end of 2021. And we believe we have appropriate levers both in terms of revenue growth from investments we're making and opportunities to reduce expenses to be reinvested in additional initiatives that will help generate revenue growth to get to the 55% efficiency ratio. We're absolutely committed to get there.

Erika Najarian
Analyst, Bank of America Merrill Lynch

Q

Okay, got it. Thank you.

Operator: Your next question comes from Matt O'Connor of Deutsche Bank.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Good morning, Matt.

Matthew Derek O'Connor
Analyst, Deutsche Bank Securities, Inc.

Q

Hi. I'm wondering. Where do market rates have to go to flatten out the NIM? Obviously, you're guiding to flattish NIM on a full-year basis, but trickling down from the 1Q level. And just conceptually, and I realize that 10-year is not the only rate that matters, but what's the breakeven point on the 10-year, where does it flatten out I think at 3.53% versus trickle down?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

If you think about the 10-year just on reinvestment on the securities book, so we're coming off a 2.70%-ish range, reinvesting in the 2.90% to 3% range, so we're getting some lift just reinvesting those cash flows over the near term. It's really not curve dynamics as much that drives versus the mix of what we put on both on the right and left side of the balance sheet.

So I think you could have – you could be where rates are in the curve, if you look where it is now and depending on what your choices are would depend on whether or not you continue to grow NII and resulting margin or whether it stays flat. We're looking to optimize our balance sheet for not only NIM, but net interest income growth, return, credit risk management, all that has to work together. And again, we've laid out our three-year expectations and our one-year expectation, and we intend to hit all of that. So, there are a lot of moving parts that you have to deal with and that's a hard one to explain.

Matthew Derek O'Connor
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. No, I understand. Just I think what's changed versus a few months ago is the rate environment versus I think your strategy, and obviously rates, they move around and were up 20 bps off the bottom and maybe two months from now will be 20 bps higher [indiscernible] (00:32:49).

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

Matt, I'd add, our expectation were that rates were going to go down at some point, which is why we began our hedging program over a year ago. As we've mentioned, we're about 75% through our hedging program right now and we did that in large part with forward-starting swaps to begin in 2020 as we expected GDP to decline to 2.5% in 2019, 2% in 2020 and 1% in 2021, and that the probability of rate cuts would increase in 2020 and 2021 and we want to be protected there. What you've seen of late is a reversal from the Fed and it put more pressure on not getting – not only not getting an increase this year, but having some probability of a cut this year, which we don't think will happen by the way. And so, that's really where we're more exposed is, if there were a cut right now, again, we'll take that risk because we don't believe that will happen.

Matthew Derek O'Connor
Analyst, Deutsche Bank Securities, Inc.

Q

Okay.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

The other point, I guess, I'd make just if I might on balance sheet optimization is, as we've indicated, we think that loan growth will begin to moderate a bit. At the same time, our core deposit base continues to grow very consistently. Consumer demand deposits grew over 4% last year. They're growing for the seventh year in a row, point to point, up about 7%. We see growth in consumer savings, consumer checking continues to grow. And so that's a more consistent, deliberate increase in deposits that will occur over time. And as that catches up with loan growth which we'll be moderating, we have an opportunity to also optimize our deposit base, and we think that will accrue to our benefit.

Matthew Derek O'Connor
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. I guess the optimization and the mix that you're talking about, I thought would have been beneficial to NIM.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Yes.

Matthew Derek O'Connor
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. But the combination of that and where we are on rates still causes it to trickle down a little bit.

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

Well, I think you could have some noise in the interim, again, we're at 3.53%. We said we'd be at 3.50% for the year, give or take a point or two. And it's going to be dependent on how well we optimize. And the 10 years move quite rapidly, it's gone from 3.50% to almost 3.60%. We're down a little bit this morning. So if – we continue to – the tenure continues to move up a little bit and the reinvestment helps us to increase net interest income and helps us from a mortgage standpoint.

Matthew Derek O'Connor
Analyst, Deutsche Bank Securities, Inc.

Q

Got it. And then, if you don't mind, I just want to squeeze in the line utilization increase of 160 basis points. Was that concentrated in like a handful of credits? And if not, I guess, what makes you think it's going to decline so much to meaningfully slow the loan growth that was so good this quarter? Thank you.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Matt, I'll ask Ronnie Smith, who heads our Corporate Bank, to answer the question. Ronnie?

Ronald G. Smith
Senior Executive Vice President & Head of Corporate Banking Group, Regions Financial Corp.

A

Yeah. Matt, it was very broad based. It was not in a handful of clients, and really focused in on most of our higher quality clients that I think David mentioned earlier that have access to other markets and we are anticipating that we'll see changes with those advanced rates as we go forward, but very broad based across industries and within geographies as well.

Matthew Derek O'Connor
Analyst, Deutsche Bank Securities, Inc.

Q

Okay, thank you.

Operator: Your next question comes from Jennifer Demba of SunTrust.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Good morning, Jennifer.

Jennifer Demba
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Thank you. Hi, good morning. Question on credit, Barb, two questions. First of all, I assume you're running parallel right now. I'm wondering if you have any preliminary estimates on what the day-one impact will be for CECL.

My second question is on your criticized leverage loans. That slide was very helpful in the deck. Is there any industry concentration within those criticized leverage credits? That's it.

Barbara I. Godin
Executive Vice President, Consumer Banking Credit Executive, Regions Financial Corp.

A

First question on CECL is yes, we are in the midst of doing a lot of work, running parallel, making sure our models are operating the way they need to, et cetera. We'll probably disclose something in the second quarter, but we're not quite ready to do that yet on the CECL front.

Relative to the leveraged loans, et cetera, there's nothing that sticks out in terms of anything that's an anomaly, so a pretty good book.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Just for clarification, I think in our second quarter release probably we'll provide some information on third quarter release, day-one impact, so we're still a ways off.

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

It will be in the third quarter release, something. We want to run parallel for a couple quarters and see what it looks like.

Jennifer Demba
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Great, thank you so much.

Operator: Your next question comes from Marty Mosby of Vining Sparks.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Good morning, Marty.

Marty Mosby
Analyst, Vining Sparks IBG LP

Q

David, I wanted to – hey, good morning. Talk to you a little bit about NII versus net interest margin. When you had a little bit of extra loan growth this quarter and then you went out and funded it, you literally could have funded it through the securities portfolio, which would have increased your net interest margin just by substituting higher rate assets – loans, being investment securities.

So I think the temporary nature of what you did or thought your loan growth is going to have and since the run up is going to come back down, you just went out and funded it, which incrementally caused some pressure on your net interest margin. And then if you look at NII, it's still growing relatively nice year over year, but you had the day count in the first quarter. So it just seems like to me the margin this quarter was exacerbated just given all in the incremental funding of the balance sheet.

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

Marty, so the NIM to us is the result of all the things that we do. And you're exactly right, what we put on – if we wanted to be fixated on our NIM, we could have done different things. I do want to make sure if I caught the fact that our NIM was impacted 1 basis point by our parent company issuance, and then we had the reclassification of our purchasing card into loans, which is a non-interest-bearing asset, so that weighed us down another point.

So we could have kept the margin relatively stable at 3.55%, but we were able to keep NII level notwithstanding two days which cost us $10 million in the quarter, so we thought it was pretty good. Again, we'll optimize the balance sheet. And those loans that we did – certain of those loans we put on had thinner spreads to them, they'll run after the capital markets, we'll get a capital markets fee when that happens, we'll remix the balance sheet and we'll be off to the races. So we're not overly fixated on the margin.

Marty Mosby
Analyst, Vining Sparks IBG LP

Q

That's what I thought. And then you talked about deposit betas and you said that through-the-cycle the cumulative beta right now is about 25%. And you said by the time we're done, we're going to be at 30%. Now that would, in general, assume that you had further rate hikes that then were going to push deposit rates up. But if we stabilize here and rates don't go up any more, let's just assume that they don't, wouldn't deposit pricing, maybe with a little bit till increase in the second quarter begin to kind of flatten out, so I just want to make sure we were being consistent with how much of the excess you expected in deposit pricing going forward.

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

So what our history tells us is that it takes about 12 months and change after the last Fed hike for deposit rates to stop moving. So that's a piece of this that you just – even if we don't get another increase, you'll see that continuing to come through. Mix has a big deal to do with it too. So as we continue to grow low-cost core checking accounts and interest-free accounts, that's helpful. But our commercial customers want to – they're trying to take their excess cash and get the best yield that they can. If rates stop moving, that will abate too.

So moving up into the 30s, we could argue where in the 30s we might end up. The point is we're going to continue to see some cost, some funding cost increases continuing to come through that we need to deal with. And we have a little bit of headwind on reinvestment on the left side of the balance sheet, and then the optimization really will carry the day for us.

Marty Mosby
Analyst, Vining Sparks IBG LP

Q

And then I guess the thing that I would suggest or highlight is that this deposit beta market has not been like any historical period we've seen in the past. It's been a lot different, and it's actually reacted much better than what we've seen in the past. So why should we expect that maybe we could see this thing slow down or actually begin to flatten out a lot quicker given that the deposit betas have been better than what we've seen in the past cycles?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

You're certainly correct that it's different. Betas last time were in the 60% range, and now we're talking in the 30% range.

Marty Mosby
Analyst, Vining Sparks IBG LP

Q

Right.

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

And part of that is because of how slow this recovery has been and the pace of those increases. You're also coming off historic lows. And so I think all that matters, and there is a chance that things flatten out quicker than we have anticipated. If that happens, then we're going to be better off than we think, and we'd much rather give you a number that we can hit versus trying to promise something that we'll struggle achieving.

Marty Mosby
Analyst, Vining Sparks IBG LP

Q

And then just last question, the swaps next year, is there any net increase in earnings from the spread lock-in, if rates were flat, given the fixed rate that you locked-in, is there – it should be a little bit of a positive spread. So I was just curious if there is some upcoming income that you're going to get out of those swaps once they actually hit the forward dates, and when does that actually happen? Thanks.

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

So the forward dates are in 2020, and you're right, we would have some positive carry there, but we also entered into some interest rate floors where you have to pay a premium and you amortize premium. So, the amortization unfortunately offsets the swap benefit. So again, if rates didn't move from here, we kind of push there...

Marty Mosby
Analyst, Vining Sparks IBG LP

Q

Got you.

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

...so you won't see any real positive carry.

Marty Mosby
Analyst, Vining Sparks IBG LP

Q

Thanks.

Operator: Your next question comes from Stephen Scouten of Sandler O'Neill.

Stephen Kendall Scouten
Analyst, Sandler O'Neill & Partners LP

Q

Hey, good morning, everyone.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Good morning.

Stephen Kendall Scouten
Analyst, Sandler O'Neill & Partners LP

Q

I'm curious just digging down on the NIM a little bit further, obviously, at Investor Day, you laid out this range of 3.40% to 3.70%. And by the commentary from you, David, that we might get to 3.50% for the year implies that the NIM will move into high 3.40s by year-end. So, can you talk to me a little bit about how that lower end, even in a zero policy range scenario, would only get down to 3.40%, and maybe what dynamics have changed since 2016 when we were at 3.15%, 3.16%, that sort of range?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

Yeah. So part of what we want to do is try to frame up the range at Investor Day like we did which changed since then was the near-term risk before our forward-starting swaps began in 2020. So even if you saw a dip in 2019, we actually start recovering that in 2020 when our derivatives kick in. So, that's the piece that gives us confidence that we're still within the range that we told you back then. If we received a rate cut in 2019, that would – we'd have a different ballgame, we'd be telling you something different. We just don't think the probability is very high that that happens. So anyway, that's – did I get...

[indiscernible] (00:45:45)

Stephen Kendall Scouten
Analyst, Sandler O'Neill & Partners LP

Q

Yeah, that's a perfect answer. Thank you. And the swaps are really what prevents you from getting down into those levels we saw back in 2016 even if we were to revert back to a similar rate environment?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

That's exactly right.

Stephen Kendall Scouten
Analyst, Sandler O'Neill & Partners LP

Q

Okay. And then just lastly, on the securities book, is there any chance that you guys look to reduce that as a percentage of average earning assets to fund some of the growth or is that kind of 22% range where you'd like to stay?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

I think there, we have a little bit in there that's helping part of our hedging program right now that works against us again on our margin. It's not a tremendously large number. We kind of like where we are from that standpoint. I think what you should expect over time is a remixing of our securities book. Today, we still have treasuries and Ginnie Maes in there that we used for LCR purposes, and to the extent that changes and maybe we can put those working a little more effectively for us into mortgage backs. So you'll see us do that from time to time. As a matter of fact, you saw us take security losses this quarter to pair off with a gain that we had on selling the affordable mortgage loans so that we could get better carry going forward and we'll pay for that in less than a year. So, those are the kinds of things you should expect us to do over time.

Stephen Kendall Scouten
Analyst, Sandler O'Neill & Partners LP

Q

Perfect, thanks so much.

Operator: Your next question comes from Saul Martinez of UBS.

Saul Martinez
Analyst, UBS Securities LLC

Q

Hey. Hey, guys. A quick – I just wanted to follow-up on the line of questioning on the deposit betas and actually just want to make sure I understand the math kind, what you guys are saying. So, the 25% through-the-cycle beta thus far basically implies that your deposit costs have moved up in the neighborhood of about 55 basis points, given where the Fed funds is at right now. If I assume no further hikes and you get to low-30s, that implies an additional 15 basis points to 20 basis points of deposit cost pressure over the next 12 months. Is my math more or less right? Is that what you're kind of baking into that assumption?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

Yeah. I think you're close, just probably closer to 10 basis points, but we're at 46 basis points of cost, one of the lowest. So when you start looking at beta and percentages, you can get some odd numbers, but we feel like – again back to, I think as Marty asked a question, if we miss it, we're going to outperform what we're telling you.

Saul Martinez
Analyst, UBS Securities LLC

Q

Got it. It's closer – I'm sorry, it's closer to 10 basis points is what you're kind of baking in in terms of incremental deposit cost pressure without any further hikes.

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

That's right. That's right.

Saul Martinez
Analyst, UBS Securities LLC

Q

Is that on total deposit or interest-bearing?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

Those are really more interest-bearing.

Saul Martinez
Analyst, UBS Securities LLC

Q

Interest-bearing, okay. I want to make sure I got that math. And then I guess on the – just a broader question, the 2% to 4% revenue, I know you've talked about NIMs and NIM sort of stabilizing at 3.5% for the full year or being at 3.5% for the full year. But the 2% to 4% revenue growth, how do we think about that in terms of your NII growth versus fee growth?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

We kind of put those together, Saul, this time, because obviously there's challenges in terms of managing earning assets and the mix and all that. So we've put that together within AR, we're still convicted that will be within 2% to 4%. Right now, there's more pressure on the NII component of that, but not enough that would cause us to not meet that goal that we had.

Saul Martinez
Analyst, UBS Securities LLC

Q

Okay. Right. Fair enough. Thanks.

Operator: Your final question comes from Gerard Cassidy of RBC.

Gerard S. Cassidy
Analyst, RBC Capital Markets LLC

Q

Good afternoon. How are you David and John – David?

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Hey, Gerard.

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

Hi.

Gerard S. Cassidy
Analyst, RBC Capital Markets LLC

Q

Can you guys give us a little further color on the portfolio break out that you've showed on leverage loans and then Shared National Credit? Are you comfortable with these levels or we're talking a year from now, are these numbers going to be much different than they are today?

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

No, I don't think so, Gerard. And I'll let maybe Barb speak as well, but I think we've established some internal limits, just as we have concentration limits for lots of other aspects of the way we manage risk in our portfolio. And we are at a level with respect to leverage lending that we are comfortable with. We expect to continue to manage, too, about the level that we're at.

I think the most risky exposure we've talked about before in the portfolio has been loans to sponsor owned companies. We brought that down from kind of the mid-30% to somewhere in the 26%, 27% range as I recall, and we'll continue to work on that to ensure that the leverage exposure that we do have is to customers that we have full relationships with, that it's in industries that we know well, distributed across a variety of different industries. So we don't have any real concentrated exposure by industry sector either. And I think we do feel comfortable with it. But I'll let Barb respond to that question as well.

Barbara I. Godin
Executive Vice President, Consumer Banking Credit Executive, Regions Financial Corp.

A

I think you've done a great job responding, John.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Thank you.

Barbara I. Godin
Executive Vice President, Consumer Banking Credit Executive, Regions Financial Corp.

A

The only thing I have to add is, just as you said, these are to our best quality C&I customers that we do leverage lending to, in particular. So we are very comfortable with them. We look at them on a regular basis. We look at the book on a monthly basis and we recycle if we see something that either is not carrying its weight or that we feel that it's probably a good opportunity for us to move out of, we take immediate action on it. So, again, I'm feeling very good with that book.

Gerard S. Cassidy
Analyst, RBC Capital Markets LLC

Q

I'm just curious, Barb, do you recall, during the last downturn, what the non – NPL percentage was for leveraged loans for Regions, we could dig it up if you don't...

Barbara I. Godin
Executive Vice President, Consumer Banking Credit Executive, Regions Financial Corp.

A

We'll have to dig it up; I don't have it off the top of my head.

Gerard S. Cassidy
Analyst, RBC Capital Markets LLC

Q

Okay. I'm not expecting that – okay, I'm not expecting that to be the same this time, but I was just curious. And maybe coming back to you, John, at Investor Day, you talked about the expansion into some priority markets: St. Louis, I believe, Atlanta, Orlando, Houston. Can you share with us how that is progressing and how do we as outsiders determine whether you're being successful in those markets?

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Well, we think it's progressing well. We have about 40 de novo branches that are now open and operating, I guess, for less than a year, largely across those markets. We continue to reposition our retail franchise. As an example, in St. Louis, as we shift that franchise and we shared this with you at Investor Day, I think we now have access to 10% more households, more wealth, more businesses, the same would be true as we think about expansion in Atlanta.

I think we now have access to more than 1 million more or nearly 1 million more customer, households, businesses and wealth. And so those opportunities continue to be available to us. Year-over-year, checking growth, about 15% of our growth is attributable to de novos. And so we'll continue to look for ways to provide you all with some information like the percentage of growth attributable to de novos as an example that'll give you some sense of how we're doing.

I think, again, core to our strategy is looking for ways to continue to grow our core customer base. So as we're growing consumer checking accounts, as we're growing debit card usage, as we're growing credit cards on the consumer side, as we're growing small business accounts and small business deposit balances, those should be indicators to you that our expansion strategy is gaining some traction. We're recruiting talent in those markets and feel good about the teams we continue to build. And all in all, I think we're going to continue to on the path to execute that strategy.

Gerard S. Cassidy
Analyst, RBC Capital Markets LLC

Q

Very good, thank you.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Thank you.

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

Let me – this is David, I just want to clean up one thing. So I think it was Saul that asked the question about the impact of beta going to the 30%, and we said more or like 10 points on. And I said interest-bearing, that's total, should be total, so if you – want to clean that up.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

Okay. I think that's all the questions we had today. Really appreciate your time. Appreciate your interest in Regions. And thank you very much. Have a good day.

Operator: This concludes today's conference call. You may now disconnect.